SC 851.

IN THE SUPREME COURT) CORAM: WILLIAMS, J.
OF PAPUA NEW GUINEA) Thursday,
21st August, 1975.

BETWEEN: WILLIAM THEODORE THOMAS
Appellant

- and -

CHIEF COLLECTOR OF TAXES
Respondent

JUDGMENT

1975
Apl. 22, 23, 24, 25
Aug. 21
PORT MORESBY
WILLIAMS, J.

The respondent in a Notice of Assessment dated the 8th October, 1973 issued under the Income Tax Act 1957, as amended, included as part of the assessable income of the appellant for the financial year ending 30th June, 1972 a sum of $204,593.00. In an adjustment sheet accompanying the Notice of Assessment this sum was described as "income derived by you being your proportion of the distribution made by Theo Thomas & Co. Pty. Ltd." Also in the Notice of Assessment the Chief Collector disallowed a claim for a deduction of $460.00 in respect of the appellant's spouse. The Notice of Assessment also included a sum of $33,613.00 as additional tax for omitted income.

In a Notice of Objection dated 30th November, 1973 the appellant asserted that the amount of $204,593.00 should be excised from his assessable income, that the deduction claimed of $460.00 should be allowed and that the additional tax should be remitted in whole or in part.

By a letter dated 23rd April, 1974 the Chief Collector disallowed the objection, whereupon the appellant, on the 13th May, 1974, requested that his objection be treated as an appeal and forwarded to this court.

1975

William Theodore Thomas

v.

Chief Collector of Taxes

Williams, J.

A Company, Theo Thomas & Co. Pty Ltd., was incorporated in Papua New Guinea many years ago. It has plantation and other business interests in the Rabaul area. At the 31st December, 1970 it had an issued share capital of 24,135 shares of $2.00 each, and at the same date the share capital and reserves of the company amounted to $695,754.00. On an asset backing basis each share was worth $28.8276. The share holdings and the value thereof were as follows:-

William Theodore Thomas (the appellant)	11,619 shares	$334,946.00
Grace G. Thomas (the appellant's mother)	6,008 shares	173,197.00
Doris M. Thomas (the appellant's wife)	500 shares	14,414.00
Margery E. Marr	6,008 shares	173,197.00
	24,135 shares	$695,754.00

During the year 1971 a number of transactions took place affecting the company and its shareholders. These transactions are said to have occurred as a result of advice given by a Mr. Burton, a Sydney accountant who handled the affairs of the company and those of the appellant and his mother.

I now propose to set out in broad outline the various transactions which were entered into.

The first step taken appears to be that the name of an existing Papua New Guinea company, Plantation Equipment Pty. Limited, was changed to Rainau Holdings Pty.Limited (I shall hereafter refer to this company as "Rainau"). Rainau then issued 10,000 $1.00 shares as follows:-

Theo Thomas Investment Co. Pty.Ltd.	6,250 shares
Gidgiewa Pty. Limited	3,750 shares
	10,000 shares

Theo Thomas Investment Co. Pty. Ltd. is an Australian company in which the appellant has the controlling interest. Gidgiewa Pty. Limited is also an Australian company in which Mrs. Marr has a controlling interest.

The shareholders in Theo Thomas & Co. Pty. Ltd. then executed transfers of their shares to Rainau. The share transfers are in evidence and show that the appellant transferred his shares for a consideration expressed to be $360,158.00, that Mrs. D.M. Thomas transferred hers for a consideration of $15,500.00, that Mrs. G.G. Thomas transferred hers for a consideration of $186,248.00 and that Mrs. Marr transferred hers for a consideration of $186,248.00.

Cheques were drawn on the bank account of Rainau (which had arranged a termprary overdraft of an amount in the vicinity of $750,000.00) in favour of each of the transferors for the consideration expressed to be payable in the share transfers and then negotiated through accounts in the name of the transferors with the Commonwealth Trading Bank at Rabaul. In the cases of Mrs. D.M. Thomas and Mrs. G.G. Thomas accounts were opened specifically for this purpose. The transferors then drew their own cheques in favour of Rainau for identical amounts, the amounts of the purchase price of the shares being treated as loans by the transferors to Rainua, repayable on demand, and loan accountswere raised in the books of that company.

There is in evidence a document (Exhibit 22) which on its face contains the Minutes of a meeting of directors of Theo Thomas & Co. Pty. Ltd. held on the 15th November, 1971 when it was resolved that a dividend of $425,000.00 be declared and credited out of accumulated profits of the company at the 30th June, 1971, such dividends to be

credited to the account of Rainau forthwith. The price of the shares acquired by Rainau was $748,154.00, but the a amount of $425,000.00 represented what, in Mr. Burton's view, represented the pre-acquisition profits standing in the books of Theo Thomas & Co. Pty. Ltd. Mr. Burton said in evidence that it was good accounting practice to bring the shares acquired by Rainau into its books at cost, less the amount of the divident credited to Rainau of the amount of the pre-acquisition profits, namely $425,000.00.

In addition to the matters which I have just outlined a number of accounting steps were taken in the books of the various companies concerned.

The assessment of the Chief Collector treats the sum of $204,593.00 as being income derived by the appellant in the financial year ending 30th June, 1972. That sum was apparently arrived at by treating as income of the appellant that proportion of the dividend of $425,000.00 declared by Theo Thomas & Co. Pty. Ltd. which his shareholding bore to the total shareholding in that company.

It is common ground that the assessment can be sustained only if resort may be had by the Chief Collector to the provisions of a s.361 of the Income Tax Act, which is in terms similar to s.260 of the Australian Act. S.361 is in the following terms:-

> "361. A contract, agreement or arrangement made or entered into, orally or in writing, whether before or after the commencement of this Act, is, so far as it has or purports to have the purpose or effect of in any way, directly or indirectly -
>
> (a) altering the incidence of any income tax or divident (withholding) tax;
>
> (b) relieving any person from liability to pay any income tax or divident (withholding) tax or make any return;
>
> (c) defeating, evading, or avoiding any duty or

liability imposed on any person by this Act; or

(d) preventing the operation of this Act in any respect,

absolutely void, as against the Chief Collector, or in regard to any proceeding under this Act, but without prejudice to such validity as it may have in any other respect or for any other purpose."

I turn now to the evidence concerning the events which preceded various transactions which I have outlined.

Mr. Burton stated that in his capacity as the company's accountant he had for some years kept a close eye on the company's financial position. He was concerned that if the company continued to make profits the value of the shares must increase and accordingly the value of the equity of the shareholders would become much greater. In this situation he was worried that upon the death of any of the shareholders difficulties would arise in finding moneys necessary to pay probate duties in that there was not sufficient liquidity of funds to meet a substantial liability for probate duty. In this respect he said he was particularly concerned in the case of Mrs. G. Thomas, who was then in her early eighties and who, in fact, died on 28th July, 1972 following an accident. Mr. Burton accordingly took the matter up with the appellant. To this end he wrote a letter to the appellant dated 11th July, 1969. In this letter he estimated that Mrs. G. Thomas' estate would be valued at approximately $180,000.00, upon which death duties would amount to approximately $70,000.00, and that there would be difficulty in finding cash resources to meet this situation. He also stated that there were various ways and means by which Mrs. G. Thomas could divest herself of property and thus effect a substantial saving in death duties, and advised that the appellant should give thorough consideration to the matter.

The appellant in a letter to Mr. Burton dated 19th July, 1969 displayed no enthusiasm for the suggestion made. He stated that he did not think that his mother

would be receptive to the suggestion, adding that "in the event of some accident whereby either my sister or myself should predecease her, and accidents do happen, we would be out of the frying pan and into the fire". He stated, however, that he would give the matter further thought.

It seems that Mr. Burton visited Rabaul fairly regularly and on visits to Rabaul continued to press the appellant to give further consideration to the matter, his suggestion being that "they freeze their estates in the Territory". Mr. Burton prepared a set of working papers, setting out his proposals which he explained to the appellant in detail.

Mr. Burton in a letter to the appellant dated 21st May, 1971 forwarded financial statements for the six months ended 31st December, 1971. In this letter is was stated:-

> ".....It is from these accounts that we can gauge the basis of transferring your shares to your new Holding Company. You will see on page one that the share Capital and Reserves of the Group amount to $695,754. This when applied to the number of shares issued (24,135) gives a value per share of $28.8276 each. When you apply this to the various shareholders, the following table sets out the positions:-
>
> | | | | |
> |---|---|---|---|
> | THOMAS. | Williams Theodore | 11,619 shares @ $28.8276 each = | $334,946 |
> | THOMAS. | Grace G.E. | 6,008 " " each = | 173,197 |
> | THOMAS. | Doris Maude | 500 " " each = | 14,414 |
> | MARR. | Marjorie Ellen | 6,008 " " each = | 173,197 |
> | | | 24,135 | $695,754 |

> Consideration will have to be given to the Capital of the company - Rainau Holdings Pty. Limited. At present the Nominal Capital is $10,000, but I feel that this will have to be increased to $100,000, and then the shareholders will have loan accounts of $695,754 less $100,000 which then becomes $595,754.
>
> As I don't want this exercise to come unstuck, I am seeking certain outside advice to protect your interests. Your company's name will not be mentioned nor will your figures be disclosed. I will be presenting on your behalf a case with these figures, but no names. As you will see, with the amount of $600,000 approximately involved, I don't want to make a mistake. I will be seeing the instructing party (a senior partner of Fell and Starkey) when I return from Walcha, and will let you know the result of my interview. Should they sanction my proposals which I have outlined in scanty detail to you verbally, then we can get the ball rolling ....."

In a letter dated 26th May, 1971 from the appellant to Mr. Burton it was stated "With regard to Rainau Holdings Limited I think you are wise to obtain an opinion from Fell and Starkey on the matter. I will wait to hear from you further on the subject."

On the 28th May, 1971 Mr. Burton again wrote to the appellant. In this letter it was said:-

> "I wrote to you on 21st May enclosing the consolidated balance sheet and accounts for the six months ended 31st December, 1971 and was setting out for you what the values of various shareholders shareholdings would be if you sold out to a holding company and thus enable funds to be distributed to the members of the family free of income tax.
>
> I mentioned in my letter that as an amount of approximately $700,000 was involved I did not want anything to come unstuck and that I was seeking

outside advice to protect your interests. Today I have had a 2 hour session with a Mr. Yates, the senior tax consultant of Fell and Starkey, Chartered Accountants here in Sydney .....
.....

I mentioned in my letter of 21st May that I felt that the nominal capital of Rainau Holdings Pty. Limited should be increased from $10,000 to $100,000. After our discussions this morning, it may not now be necessary to take the capital beyond the $10,000 limit. My original proposal was that the structure in the new company be as follows:-

Rainau Holdings Pty. Ltd.

Proposed Share Capital & Loan Accounts

	$1 Shares Capital	Loan Account	Total
W.T. Thomas	48,000	286,946	334,946
G.G.E. Thomas	25,000	148,197	173,197
M.E. Marr	25,000	148,197	173,197
D.M. Thomas	2,000	12,414	14,414
	$100,000	$595,754	$695,754

Under Section 144 of the Income Tax Ordinance, 1959-67, the Chief Collector could, if he deemed expedient, class the repayments of the loan as a dividend, if the shareholders in Rainau Holdings were the same persons who were ownd money by the company. It is felt that it would be better to have 'different' shareholders in Rainau Holdings other than yourself, wife, mother and sister. A means of getting over this problem could be to substitute your private investment companies as the new shareholders. This would then mean that the share capital of Rainau Holdings Pty. Limited would be held by Theo Thomas Investment Company Pty. Limited, Gidgiewa Pty. Limited and only if you absolutely insist, Ravuvu Investments Pty. Limited.

Suggested Share Structure:

	No. of $1 Shares
Theo Thomas Investment Company Pty. Limited	6,250
Gidgiewa Pty. Limited	3,750
	10,000

If you agree on the above share structure, then the loan accounts would be:

W.T. Thomas	$ 286,946
G.G.E. Thomas	$ 148,197
M.E. Marr	$ 148,197
D.M. Thomas	$ 12,414
	$ 595,754

You may wonder on my reason for leaving out Ravuvu Investments and I know that you may not agree at this juncture. If you don't, then we could incorporate it into the new share structure. However, having considered your mother's age and her loan account with an existing balance of $173,000, I feel that there is no point in making her probate any higher by future declarations of dividends, etc. and that all payments to your mother in the future should be used to reduce her loan account .....
....."

The appellant replied to this letter on the 3rd June, 1971. In his reply the appellant stated:-

"Thank you for your letter of the 28th May, and the details regarding the proposed company, Rainau Holdings Pty. Ltd. There are a few very minor questions that I would like cleared up, but they would not be of any great significance, and rather than write back and forth on the matter, I won't hold up the proposal.

I therefore agree to the suggested share structure whereby Theo Thomas Investment Co. Pty. Ltd. and Gidgiewa Pty. Ltd. become the shareholders, and the loan accounts as enumerated on page 2. of your letter. You may go ahead now and complete all the necessary formalities. I have already discussed the matter with my sister and she is prepared to leave the matter in my hands ....."

I turn now to a letter upon the contents of which the Chief Collector places considerable reliance. It is a letter dated the 4th June, 1971 from Fell and Starkey to Mr. Burton and was evidently written following the consultation which Mr. Burton had with Mr. Yates of Fell and Starkey. In this letter it is stated:-

" THEO THOMAS & COMPANY PTY. LIMITED

We refer to our recent discussions concerning the above company and its considerable accumulated profits and reserves. You have asked for our advice on a means of diverting cash from the company to its shareholders without subjecting the latter to income tax in respect of any such cash distributions. The Company's shares are beneficially owned by four individuals, three of whom are residents of the territory for the purposes of Australian and Territory income tax whilst the remaining shareholder is a resident of Australia for the purposes of income tax in both territories.

Obviously, any dividend declared by the company to its shareholders will attract territory income tax in their hands, limited to the Territory rate in respect of dividends paid to those shareholders resident in the Territory, but subject overall to the higher Australian rate in respect of dividends paid to the Australian resident shareholder. The Australian shareholder would be subject to Australian income tax in respect of any such dividends with credit granted in Australia for any Territory tax suffered. Further, as you have appreciated, any

loans or advances made by the company run the risk of falling foul of the provisions of section 144 of the Income Tax Ordinance of the Territory of Papua and New Guinea and section 108 of the Australian Income Tax Assessment Act, this latter section having effect in relation to any loans, advances etc. made to the Australian shareholder. Section 144 of the Ordinance and section 108 of the Act are worded in almost identical terms and, broadly speaking, the sections provide that so much of the amount of value of advances, loans or payments made by a private company to or on behalf of its shareholders as, in the Commissioner's opinion, represents distributions of income of the company, are deemed to be dividends paid by the company.

In view of the large accumulated profits in the company, built up because of its conservative divident policy in relation to profit earned, due mainly to the absence in the Territory of a rate of undistributed profits tax, we consider that loans, advances etc. to shareholders would most likely be deemed dividends by the respective Commissioners and thus attract income tax.

You have suggested incorporating a further company in the Territory which will acquire from the shareholders of Theo Thomas & Company Pty. Limited the shares they hold in that company. The purchase consideration for the shares will reflect the company's accumulated profits and reserves. The profit arising from the sale will be a capital profit and will not attract income tax in the hands of the shareholders, either in the Territory or in Australia. You intend the purchase price for the shares will remain on loan account, interest free and payable on demand, and that the loan account will be extinguished from cash funds derived from dividends paid by Theo Thomas & Company. These dividends will be much greater in amount than those previously paid, and the new parent company, after paying a dividend equal to that paid previously by

Theo Thomas & Company will use the balance for part repayment of the Theo Thomas & Company shareholders' loan accounts. It was your intention to have the same shareholders, holding shares in some proportion as in Theo Thomas & Company, as the shareholders in the new company. We believe that here again we will be confronted with the hurdle of sections 144 and 108, mentioned previously, when loan repayments are made to the shareholders and to avoid any deemed dividend problems we suggest that the shareholders in the Theo Thomas & Company not be shareholders in the new company, at least until the loans are repaid. You have told us that each of the Theo Thomas & Company shareholders has a family company and we suggest that these companies be the shareholders in the new company.

This procedure should not create any income tax problems in the Territory so far as the existing shareholders in Theo Thomas & Company or the new shareholders in the proposed Territory parent company are concerned. In fact, there could be a saving of income tax in that dividends previously flowing to individuals will now flow through the parent company to the family company where they may be 'spread' among the various family company shareholders.

The Australian family company (Mts. M.E. Marr) will receive its dividends free of Territory income tax and virtually free of Australian company tax. Although dividends paid by resident Territory companies are technically liable to Territory dividend withholding tax, section 217 of the Territory Ordinance limits withholding tax in respect of Australian resident recipients to the amounts of Australian tax payable on the dividend. In the case of Australian resident companies, generally, any dividends received are rebateable under section 46 of the Australian Act and, in effect, are free of Australian tax ....."

A copy of the opinion of Fell and Starkey was forwarded by Mr. Burton to the appellant on the 11th June, 1971. It also appears that a copy of this opinion was forwarded to Mrs. Marr and her accountants in Orange, New South Wales. Under cover of a letter dated the 20th June, 1971 Mrs. Marr forwarded to the appellant a copy of the opinion of Fell and Starkey. In this letter Mrs. Marr, whilst expressing some reservations concerning her understanding of the proposals, agreed that the proposals be implemented.

The appellant wrote a letter to Mr. Burton dated 11th June, 1971. In it he referred to his letter of the 3rd June, 1971 and stated that he agreed in principle with the proposed share structure of Rainau, but requested further information as to the detail before signing anything himself or having his sister or mother sign.

Mr. Burton replied to this letter on the 15th June, 1971. In it he set out the proposed share holdings in Rainau and the amounts of the various loan accounts. He also said:-

> "Your assumptions were correct in that your mother and your wife would disappear from the share register and would not be shareholders in Rainau Holdings Pty. Limited. All amounts paid to them in the future would be tax free and would be applied in the reduction of their loan accounts.
>
> You also raise the matter in regard to the monthly amounts you draw at present. Your assumptions were correct again, that these monthly payments would continue but they would be paid from Rainau Holdings Pty. Limited and not from Theo Thomas & Company Pty. Limited. <u>All monthly payments</u> to yourself, your sister, and your mother, would continue to be paid to you people as individuals until the loan accounts were extinguished."

It was also suggested in this letter that the share transactions should be deferred until August.

Mr. Burton wrote a further letter dated 18th June, 1971 to the appellant. In this it was again suggested that the transactions be not finalized until August. In this letter it was stated:-

> " I am sorry that we can not get the matter finalized this year. However it is not just a matter of signing share transfers and having them stamped with the authorities but it also involves numerous exchange cheque transactions and this I honestly feel must be carried out step by step otherwise the whole exercise may become unstuck."

I advert again to the letter from Fell and Starkey. What did it envisage? In the opening paragraph reference is made to recent discussions concerning the company and its considerable accumulated reserves and profits. The paragraph then proceeds -

> "You have asked for our advice on a means of directing cash from the company to its shareholders without subjecting the latter to income tax in respect of any such cash distribution."

This paragraph, taken with other references in the letter, clearly shows that its author was pre-occupied with income tax matters and in this connection it might be noted that upon the evidence Mr. Yates of Fell and Starkey is a specialist income tax consultant. It might also be noted that nowhere in the letter is there a reference to what might be termed estate planning matters as such.

It is apparent from a perusal of this letter that its author was aware that Theo Thomas & Co. Pty. Limited had large accumulated profits, and that any dividend declared would be taxed in the hands of its shareholders. In this context the author then considers the proposal said in the letter to have been made by Mr. Burton, namely that a further company be incorporated in Papua New Guinea which would acquire from the shareholders of Theo Thomas & Co. Pty. Ltd. their share holdings; that the purchase consideration for the shares would reflect the company's accumulated profits and reserves; that the profit arising

from the sale will be a capital profit and will not attract income tax in the hands of the shareholders, either in Papua New Guinea or Australia; that the purchase price for the shares would remain on loan account, interest free and payable on demand; that the loan account would be extinguished from cash funds derived from dividends paid by Theo Thomas & Co. Pty. Ltd; that these dividends would be much greater in amount than had previously been paid and that the new parent company after paying a dividend equal to that paid previously by Theo Thomas & Co. Pty. Ltd. would use the balance for part repayment of the loan accounts of the shareholders in Theo Thomas & Co. Pty. Ltd.

Mr. Burton in his evidence claimed that in some respects the letter did not accurately represent what he had said to Mr. Yates at their meeting which preceded the letter. To use his words, "Mr. Yates took the bit$\frac{3}{4}$ between his teeth slightly and took into account matters additional to what I discussed with him." In particular, he denied that it had been discussed that the loan account will be extinguished from cash funds derived by dividends paid by Theo Thomas & Co. Pty. Ltd., that these dividends would be much greater than those previously paid and that the new parent company, after paying a dividend equal to that paid previously by Theo Thomas & Co. Pty. Ltd., would use the balance for part payment of the loan accounts of the shareholders of Theo Thomas & Co. Pty. Ltd. Mr. Burton said that these matters had not been discussed because "first of all, if a dividend was declared there were no cash funds from which to pay any sums and, secondly, that under the scheme which was envisaged that the dividend income which Rainau would be entitled to and distributes to their shareholders would only be that income received after the date of purchase."

Mr. Burton also stated in his evidence that he consulted Mr. Yates "in conjunction with any dividends that may subsequently be paid if an estate planning scheme was instituted. At that particular stage there was no thought of the company paying any dividends to any of the shareholders." The following questions and answers also appear in his evidence:-

"Q. Well now, would you agree with this much, that Mr. Yates in the course of your conference fastened on to or became interested in the possible income tax complications that might arise in the course of the Estate Planning?

A. Yes.

Q. And one of the things discussed was possible difficulties in getting the undistributed profits out of Theo Thomas & Co. Pty. Limited into the old beneficial ownership of the persons concerned tax free?

A. Correct.

Q. And questions were discussed between yourself and Mr. Yates of how dividends could be declared out of Theo Thomas & Co. Pty. Limited which would not bring about taxation with the particular sums in the hands of the recipient?

A. Correct.

Q. And it was discussed between you and Mr. Yates that when the reorganisation had been affected there would at some stage be a declaration of dividends out of Theo Thomas & Co. Pty. Limited in respect of the undistributed profits in that company?

A. No, I do not think there was.

.....

.....

Q. That of course involved, did it not, there being funds available in Rainau for repayment of the purchase price of the shares. What was the plan on where the money was coming from for that repayment?

A. We did not have a plan.

Q. There would in fact be only two ways in which the money owed by Rainau to repay the vendors for their sale price for the shares, namely a dividend payment from Theo Thomas & Co. Pty. Ltd. or loan from Theo Thomas & Co. Pty. Ltd. Would that be right?

A. That is correct."

I have already made reference to the denial by Mr. Burton that he had discussed with Mr. Yates that the loan accounts would be extinguished from dividends declared by Theo Thomas & Co. Pty. Ltd. Mr. Burton did, however, agree that a topic of the discussion was how to get undistributed profits of Theo Thomas & Co. Pty. Ltd. into the hands of the shareholders tax free. It seems to me far more probable than not that the statements attributed to Mr. Burton in the letter from Fell and Starkey were in fact made. I prefer the account given in the letter which was written shortly after the consultation to Mr. Burton's recollection of events several years later. Reference might also be made to Mr. Burton's letter to the appellant dated 15th June, 1971, the contents of which I have earlier set out.

Upon a consideration of all the evidence it seems to me that whilst the matter may well have had its origin in the mind of Mr. Burton as an estate planning scheme that following the consultation with Fell and Starkey the incidence of income tax loomed very large in the minds of the parties, and that whilst the expressed aim of Mr. Burton to "freeze" the assets of the original shareholders of Theo Thomas & Co. Pty. Ltd. may have been achieved there nevertheless was produced a scheme which envisaged that so far as the appellant was concerned his original shareholding in Theo Thomas & Co. Pty. Ltd. should be disposed of, but that he retain effective control of it through his family company. At the same time he would receive payments emanating from dividends paid by Theo Thomas & Co. Pty. Ltd. which would be treated as capital sums in repayment of the

purchase price of the shares, but which, without the scheme, would be payments having the character of income.

As has been mentioned earlier the assessment the subject of this appeal is founded upon the declaration of a dividend of $425,000.00 by Theo Thomas & Co. Pty. Ltd. on 15th November, 1971 and treats $204,593.00 of that sum as income of the appellant. It was asserted by Mr. Burton that the declaration of the dividend on 15th November, 1971 had nothing to do with the implementation of any scheme but was arranged by him without any consultation with anyone, and was done purely as an accountancy step to "tidy up" the books following the completion of the share transfers to Rainau. It is clear from the evidence that it was initially proposed that the arrangements contemplated be put into effect by 30th June, 1971. However, this was found to be not possible having regard to have the share transfers stamped. Mr. Burton proposed that the share transfers be stamped in Norfolk Island, thus avoiding stamp duty, a proposal in which the appellant did not concur. Subsequent enquiries by Mr. Burton of the Stamp Duty authority in Port Moresby revealed that the transfers could not be stamped there before 30th June, 1971. The implementation of the scheme was accordingly deferred to the following financial year. The share transfers are dated 5th October, 1971 and were stamped in Port Moresby. Upon the evidence, he received the share transfers back in November, 1971 and upon their return made necessary entries in the books of Rainau. He asserted that, prior to this, no thought had been given to the declaration of a dividend by Theo Thomas & Co. Pty. Ltd., and that he took the steps necessary for the declaration of the dividend contained in the minutes of the meeting of the directors of Theo Thomas & Co. Pty. Ltd. purely as an exercise in the "tidying up" of the books. I think it plain from the contents of the letter from Fell and Starkey, which contained, in my view, the scheme to be implemented, that the declaration of a dividend or dividends was contemplated. Further, upon the evidence it had been the practice in years preceding the financial year ending 30th June, 1971 for Theo Thomas & Co. Pty. Ltd. to declare a dividend. This practice was not followed following the close of the year ending 30th June, 1971. Mr. Burton, who

obviously had a close and detailed knowledge of the affairs of the company, was asked why the usual practice had not been followed. He said he did not know and added that the company was not under an obligation to declare one. I think that the inference is strong that a dividend was not declared because of the proposed scheme, and that the declaration of a dividend was deferred until the scheme had been implemented. Immediately the transactions were completed a dividend was in fact declared. I am unable to accept that this occurred merely as an afterthought in the process of "tidying up". Rather I think it was done in pursuance of the scheme.

During the evidence of the appellant it emerged that the meeting of directors of Theo Thomas & Co. Pty. Ltd. recorded in Exhibit 26 did not in fact take place. It appears that the document was prepared in Sysney by Mr. Burton and sent to Rabaul. Mr. Thomas was on 15th November, 1971 in Sydney and did not return to Rabaul until a date subsequent to 15th November, 1971. Upon his return he merely signed the document, no meeting of directors taking place. It was contended on the appellant's behalf that there was no decision by the directors to declare a dividend and that Mr. Thomas could not, under the Articles of Association of the company, bind the company by signing the minutes. Therefore, as a matter of law, no dividend had been declared.

Objection was taken by counsel for the Chief Collector that this point could not be taken, inter alia, on the ground that it was not raised by the Notice of Objection. S.250(a) of the Act provides that upon an appeal the taxpayer is limited to the grounds of his objection.

I am aware that courts have often given a liberal construction to the Australian counterpart of this section. However, in the circumstances of this case it is clear that the fact that there was no meeting of directors was one peculiarity within the knowledge of the appellant. So far as the Chief Collector was concerned, he had no reason to believe or suspect that the divident declaration

was not duly made, as represented in the company's records, when considering the appellant's objection. As I understand the purpose of the section, it is to confine the issues raised in an objection in order to enable the Chief Collector to give consideration to the matters raised in the objection before allowing or disallowing it. As I see it there is nothing in the Notice of Objection from which the Chief Collector could have understood or inferred that the appellant was raising a question of the validity of the dividend declaration. In the circumstances, I hold that this point is outside the ambit of the objection and cannot properly be relied on in this appeal.

I turn now to some evidence given by the appellant in relation to his understanding of the transactions entered into. The following appears in his cross-examination:-

> "Q. It would be right to say, would it not, that at that stage you regarded what was set out in Fell and Starkey's letter as the proposal that was for consideration by yourself and the members of your family who were concerned with the transaction?
>
> A. Together with Mr. Burton's explanation of it, yes.
>
> Q. But for example in handing over the letter to your sister and her husband you gave them that letter and I suppose you added your understanding of the matter in handing it over to them. What they had to take away to study was the Fell and Starkey letter?
>
> A. Yes.
>
> Q. And although you had had the benefit of explanation from Mr. Burton in addition to what was in the letter is it right your understanding was that that letter dealt with the proposals you were considering?

A. Yes.

Q. But to anyone who could understand the letter sufficiently within the letter there was contained everything that a person would need to know to understand what it was that was being proposed?

A. That is correct.

Q. And you yourself whilst having a general understanding of the subject, or thinking you had a general understanding of what was to be done were content to leave the actual carrying out of the scheme to Mr. Burton on the advice of Fell and Starkey?

A. Yes, but I gave him latitude to use his own discretion.

Q. Yes I put that rather badly. You had specifically wanted to make certain that Mr. Burton had the benefit of the best advice he could get?

A. Yes.

Q. As you understood it the letter from Fell and Starkey embodied that firm's viewpoint of what Mr. Burton had proposed with some modifications because of their own expertise?

A. That is correct.

Q. And having reached that point you and likewise your mother and sister and wife were content to leave the matter to Mr. Burton to carry through?

A. That is correct."

Upon a consideration of the whole of the evidence I am satisfied that the letter from Fell and Starkey sets out the substance of the scheme contemplated by the appellant

and the other shareholders of Theo Thomas & Co. Pty. Limited, and which Mr. Burton was authorised by them to implement.

S.361 of the Papua New Guinea Income Tax Act has as its Australian counter-part s.261. That section has been the subject of much judicial consideration. The facts in relation to most of these cases are complex in the extreme, but a number of principles have been enunciated in relation to the section.

Perhaps the leading case in the field is that of Newton v. Federal Commissioner of Taxation. That case in the first instance came before a single Justice of the High Court of Australia, then went on appeal to the Full Court of the High Court of Australia, and again on appeal to the Judicial Committee of the Privy Council. The Privy Council decision is reported in (1957-58) 98 C.L.R. 2. I now propose to refer to some of the principles pronounced in the judgment of their Lordships delivered by Lord Denning in that case. At p.8 it was said:-

> "..... the section is not concerned with the motives of individuals. It is not concerned with their desire to avoid tax, but only with the means which they employ to do it. It affects every 'contract, agreement or arrangement' (which their Lordships will henceforward refer to compendiously as 'arrangement') which has the purpose or effect of avoiding tax. In applying the section you must, by the very words of it, look at the arrangement itself and see which is its effect - which it does - irrespective of the motives of the persons who made it. Williams, J. put it well when he said 'The purpose of a contract, agreement or arrangement must be what it is intended to effect and that intention must be ascertained from its terms. These terms may be oral or written or may have to be inferred from the circumstances but, when they have been ascertained, their purpose must be what they effect.' In order to bring the arrangement within the section you must be able to predicate - by looking at the overt acts by which it was implemented - that it was implemented in that particular way so as to avoid tax.

> If you cannot so predicate, but have to acknowledge that the transactions are capable of explanation by reference to ordinary business or family dealing, without necessarily being labelled as a means to avoid tax, then the arrangement does not come within the section."

Applying these principles to the present case it is my view that there was an arrangement within the meaning of s.36l.

I now pose the next question, which was posed in Newton's case (supra) (1). That question is "What was the purpose of the arrangement?" On the view I take of the matter there were two purposes:-

> (1) To "freeze" the assets of the original shareholders in Theo Thomas & Co. Pty. Ltd. for estate duty purposes.
>
> (2) To enable distributions to be made from accumulated profits of Theo Thomas & Co. Ltd. Limited to reach its original shareholders in the form of non-taxable capital sums which sums but for the arrangement would be taxable income.

On these findings it appears that avoidance of tax was not the sole purpose or effect of the arrangement. Nevertheless s.36l can still work if one of the purposes or effects was to avoid liability for tax (see Newton's case (supra) (2)).

In that case it was said at p. 10:-

> "It is clear from this analysis the avoidance of tax was not the sole purpose or effect of the arrangement. The raising of new capital was an associated purpose. But nevertheless the section can still work if one of the purposes or effects was

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(1) (1957-58) 98 C.L.R. 2 at p.9

(2) (1957-58) 98 C.L.R. 2 at p.10.

to avoid liability for tax. The section distinctly says 'so far as it has' the purpose or effect. This seems to their Lordships to import that it need not be the sole purpose.

Looking at the whole of this arrangement, their Lordships have no doubt that it was an arrangement which is caught by s.260. The whole of the transactions show that there was concerted action to an end - and that one of the ends sought to be achieved was the avoidance of liability for tax."

However in Mangin v. Inland Revenue Commissioner (3) there appears in the majority judgment delivered by Lord Donovan a passage which seems to be in conflict with what was said in Newton's case (supra) (4). This passage, at p. 751, is as follows:-

"Both sides relied upon the decision of the Board in Newton v. Commissioner of Taxation of the Commonwealth of Australia (1958) A.C. 450. This was a decision upon section 260 of the Australian Income Tax etc., Act 1936-1951 - a section apparently copied from section 82 of the New Zealand Act of 1900 above quoted. The judgment was delivered by Lord Denning and in the course of it he said, at p. 466:

' In order to bring the arrangement within the section you must be able to predicate - by looking at the overt acts by which it was implemented - that it was implemented in that particular way so as to avoid tax. If you cannot so predicate, but have to acknowledge that the transactions are capable of explanation by reference to ordinary business or family dealing, without necessarily being labelled as a means to avoid tax, then the arrangement does not come within the section.'

In their Lordships' view this passage, properly

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(3) 1971 A.C. 739
(4) (1957-58) 98 C.L.R. 2

interpreted, does not mean that every transaction having as one of its ingredients some tax saving feature thereby becomes caught by a section such as section 108. If a bona fide business transaction can be carried through in two ways, one involving less liability to tax than the other, their Lordships do not think section 108 can properly be invoked to declare the transaction wholly or partly void merely because the way involving less tax is chosen. Indeed, in the case of a company, it may be the duty of the directors vis-a-vis their shareholders so to act. Again, trustees may in the interests of their beneficiaries, deliberately choose to invest in government securities issued with some tax-free advantage, and to do so for the express purpose of securing it. They do not thereby fall foul of section 108. The clue to Lord Denning's meaning lies in the words 'without necessarily being labelled as a means to avoid tax'. Neither of the examples above given could justly be so labelled. Their Lordships think that what this phrase refers to is, to adopt the language of Turner, J. in the present case,

'a scheme. . . devised for the sole purpose, or at least the principal purpose, of bringing it about that this taxpayer should escape liability on tax for a substantial part of the income which, without it, he would have derived.' "

In Hollyock v. Commissioner of Taxation of the Commonwealth (5) Gibbs, J. had occasion to consider the apparent conflict between Newton's case (supra) (6) and Mangin's case (supra) (7). After reviewing a number of authorities he said at p. 575:-

"With great respect, I cannot accept that the words which Turner J. used (see (1970) N.Z.L.R. 222, at p. 236) to refer to the facts of the case before him, but which their Lordships adopted as

(5) (1971) 45 A.L.J.R. 572
(6) (1957-58) 98 C.L.R. 2
(7) 1971 A.C. 739

indicating the meaning of Lord Denning's remarks, express completely the effect of s.260. To say that the section applies only to arrangements whose sole purpose is tax avoidance would be contrary to the decisions in Newton's case and Hancock v. Federal Commissioner of Taxation, supra. To hold that tax avoidance should be the principal purpose of the arrangement would seem to me to be opposed to the reasoning on which those decisions rest, and would introduce into s.260 a refinement which is not suggested by the words of the section itself, and which would tend to increase, rather than remove, the difficulties to which the section gives rise, by requiring the courts to weigh one purpose against another and to decide which was predominant. An arrangement may, for example, be designed to secure both the avoidance of income tax and the avoidance of death duties - each purpose may be equally important - and in such a case the arrangement does not in my opinion escape from s.260 simply because it cannot be held that the avoidance of tax is the principal purpose of the scheme. On the other hand, if tax avoidance is an inessential or incidental feature of the arrangement, that may well serve to show that the arrangement cannot necessarily be labelled as a means to avoid tax."

I adopt, with respect, these observations of Gibbs, J. In my view tax avoidance was not an incidental feature of the arrangement entered into but was an important part of it.

I turn now to what appears to me to be the most difficult aspect of this matter. What, so far as the assessment under appeal is concerned, was effected by the arrangement? In the financial year under consideration, the appellant did not, with the exception of a comparatively small amount to which I shall later advert, actually receive any money. In this respect it was contended on the taxpayer's behalf that unless there can be found money in the hands of the taxpayer the assessment is not authorised. In this respect reliance was placed upon Newton's case (supra)(8)

(8) (1957-58) 98 C.L.R. 2

and a number of other cases. The passage in Newton's case (supra) (9) relating to s.260 relied on is to be found at p. 10 of the report and is as follows:-

> "In the words of the Courts of Australia, it is an 'annihilating' provision the Commissioner can use the section so as to ignore the transactions which are caught by it. But the ignoring of the transactions or the annihilation of them - does not itself create a liability to tax. In order to make the taxpayers liable, the Commissioner must show that some moneys have come into the hands of the taxpayers which the Commissioner is entitled to treat as income derived by them. Their Lordships agree with the way in which Fullagar, J. put it in his judgment: 'Section 260 alters nothing that was done between the parties. But for purposes of income tax, it entitles the Commissioner to look at the end result and to ignore all the steps which were taken in pursuance of the avoided arrangement.' "

Reference might here be made to the case of Bell v. Federal Commissioner of Taxation (10). I do not propose to canvass the facts of that case in detail, but it was found that there was an arrangement caught by s.260, and that the net result was that the appellant received in cash £11,000.0.0 as a capital receipt rather than as an income receipt. The point of the case, for present purposes, is that there was found in the hands of the appellant a cash sum.

I turn now to the case of Hancock v. Federal Commissioner of Taxation (11). Dixon, C.J. at p. 279, after citing passages from the judgment of the Privy Council in Newton's case (supra) (12), said:-

> "It is here that the difficulty of the case arises. The change or enhancement in the position of George Hancock, what had come into his hands,

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(9) (1957-58) 98 C.L.R. 2
(10) (1951-53) 87 C.L.R. p. 548
(11) (1962-63) 108 C.L.R. 258
(12) (1957-58) 98 C.L.R. 2

> what he had derived, at the ultimate end of the transaction was his proportion of the shares of the Lefroys and his proportion of the £2,500. I do not think that when Lord Denning employed the word 'moneys' in the passage last quoted he intended to distinguish between moneys and any other form of asset the receipt of which may constitute the derivation of income such as an immediately convertible security. But shares in a proprietary company may not be within that category..... ..... When all the movements of credit are treated as over and the result simply (as distinguished from the movements or ostensible movements of credit and money by which the result was accomplished) is looked at and compared with the position from which it began, what has been effected is seen to be the acquisition by the Hancocks of the Lefroys' shares together with a sum of £2,500 added .... Indeed the point of the whole arrangement that has been considered void as against the Commissioner was to effect a liberation of the fund of profits without incurring tax and at the same time by means of the fund liberated to acquire the shares of the Lefroys."

Kitto, J. in Hancock's case (supra) (13) at p.282, after referring to the notorious difficulties of the section, which had been productive of a line of cases culminating in Newton's case (supra) (14), went on to expound a number of general propositions which may be implied from the decision of the Privy Council in Newton's case (supra)(15). He discussed the meaning of the word "arrangement", the words "has or purports to have the purpose or effect" and the considerations by which the character of the transactions may be determined. He continued:-

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(13) (1962-63) 108 C.L.R. 258
(14) (1957-58) 98 C.L.R. 2
(15) (1957-58) 98 C.L.R. 2

"(5) But the overt acts will enable the arrangment to be characterized as a means for the avoidance of tax, if they have included a transfer of property from the taxpayer in consequence of which income from the property, instead of being received as such by the taxpayer, has followed either of two courses: (i) a course which has carried it through the hands of other persons to the taxpayer, but so as to reach him with the character of capital; or (ii) a course which has amounted in effect to an application of the moneys by the taxpayer, and so has been a practical equivalent of a receipt by him followed by an expenditure by him .....

.....

(7) Where an arrangement is found to be within the section because of a transfer having such a consequence as is mentioned in (5) above, the transfer is to be considered as void to the extent mentioned in the section. The result is that income which has followed either of the courses referred to in (5) is to be regarded as income to which the taxpayer was entitled. Consequently the receipt of the income by the transferee in pursuance of the arrangement is properly to be treated by the Commissioner as a derivation of it, as income, by the taxpayer."

His Honour then added an explanation of propositions (5) and (7) in these terms:-

"A clear example of income following the first of the courses mentioned is provided by Bell's case, where it was found possible to trace dividend moneys from a company to Bell, and show that although they had in fact reached Bell as capital they were the produce of shares formerly held by him and transferred under an arrangement which ensured that he would receive them, but receive them transformed into capital and so made free of income tax. The Privy Council regarded the bulk of the moneys in question in Newton's case as in the same category. The second of the courses described in (5) above is illustrated by the Privy Council's treatment of the moneys retained by Pactolus in Newton's case. It is easy to

> imagine other possible instances of it. One would be the case in which, by arrangement between A and B, A has transferred his shares to B, and B has applied dividend moneys therefrom in making a payment to C but really as a gift to C from A, or in paying for property to be transferred by C to A, or in securing some benefit or advantage for A, and then (making plain the tax-avoiding nature of the whole arrangement) B has retransferred the shares to A."

The propositions expounded by Kitto, J. in Hancock's case (supra) (16) were adopted by a Full Court of this Court in The Chief Collector of Taxes v. Bailes (17). I also, with respect, adopt them.

In the present case the appellant, unlike the taxpayers in many of the decided authorities in this field, had no pressure upon him in the sense that he had an impending liability to tax. At the relevant time no Division 7 tax was payable in this country and in consequence Theo Thomas & Co. Pty. Ltd. was not in a position where it was forced to make any declaration of a dividend to relieve liability upon it to pay a dividend withholding tax. In consequence the appellant was not faced with any tax liability unless and until a dividend was declared by Theo Thomas & Co. Pty. Ltd. and received by him as such. What was, however, in my view, achieved by the arrangement was that his rights to receive a dividend, if and when declared, were transformed into a right to demand and receive repayments of loan moneys which would not be taxable in his hands. But what I think is of considerable significance in this case is that upon the evidence as I understand it when the dividend in the sum of $425,000 was declared this sum was credited in the books of Rainau but not physically paid to Rainau. No sum of money (with the exception to which I shall later refer) has been received by the appellant in the financial year with which I am concerned in pursuance of the arrangement. Thus, it seems to me, that the first course referred to by Kitto, J. in his proposition (5) previously referred

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(16) (1962-63) 108 C.L.R. 258
(17) 73 A.T.C. 4065

to is not satisfied in the circumstances of this case. Nor, in my view, can it properly be said that the second course has been satisfied, in that there has been no practical equivalent of a receipt by him followed by an expenditure by him. There is in the books of Rainau a debt owing to him which, for one reason or another, he may never receive. An examination of the balance sheets of Theo Thomas & Co. Pty. Ltd. and Rainau as at the relevant times indicate that cash resources were not available to pay the debt owing to the appellant if demanded, or anything like that amount. It accordingly seems to me quite contrary to the known facts to treat the appellant as having received in the year of income under review a sum of $204,593. I do not think that it can be properly said that the arrangement had the purpose or effect of relieving the appellant from liability to pay income tax on the sum of $204,593 in the year of income in respect of which the assessment under appeal was made.

An alternative argument put on behalf of the appellant was that if it be found that a s.361 arrangement existed then the only amount that could be said to have reached the hands of the appellant in the income year in question is an amount of $9,334.26, appearing in the loan account of the appellant against the date 30th September, 1971. In this respect it is to be noted that ground (a) (iv) of the Notice of Objection refers to an amount not exceeding $35,056.54 as being paid to the appellant by Rainau in the income year ended 30th June, 1972. I do not understand the reference to $35,056.54, and it does not appear to accord with the copy of the loan account of the appellant (Exhibit 26). It seems to me that upon the evidence before me the only amount that can be said to have passed to the appellant in the year ended 30th June, 1972 as a result of the arrangement is the sum of $9,334.26. However, as pointed out by counsel for the appellant he was in the financial year entitled to a deduction of $14,757 in respect of a loss incurred in his Australian activities. In the result, therefore, he had no assessable income during the year ended 30th June, 1972.

This appeal is also concerned with the disallowance by the Chief Collector of a claim in respect of the appellant's

spouse. In the background of the whole matter this is relatively unimportant. It may be that some income came to Mrs. Thomas in the relevant income year as a result of the arrangement which I have found to exist. Upon the evidence before me I am unable to say what (if any) separate income was derived in the relevant year by her. Accordingly it seems to me that the appellant has not discharged his onus of showing that the Chief Collector's disallowance of his claim for a deduction for his spouse was wrong.

In this appeal the appellant also seeks the deletion or remission of $33,613 additional tax included in the assessment with respect to the alleged omission by the appellant from his return of the sum of $204,593. Upon my findings this sum was not omitted but the amount of $9,334.26 was omitted. Obviously the imposition of additional tax in the sum of $33,613 cannot stand but it may be argued that some other amount should be substituted.

In the circumstances I will not make any formal orders at this stage but propose adopting the course of publishing these reasons and leaving it open for the parties should they desire to argue the question of penalty and the further question of the costs of this proceeding.

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